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SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1944

No. [redacted] 84

PARADISE LAND AND LIVESTOCK COMPANY,
A CORPORATION,
PETITIONER,

VS.

THE FEDERAL LAND BANK OF BERKELEY,
RESPONDENT.

BRIEF FOR RESPONDENT IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE TENTH CIRCUIT.

RICHARD W. YOUNG,
MORTON G. HOFFMANN,
(Berkeley, California)
Counsel for Respondent.

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To the Honorable Chief Justice and Associate Justices of the Supreme Court of the United States:

I

STATEMENT OF FACTS

On March 10, 1938, a foreclosure decree was entered in the state court of Utah in favor of respondent and against petitioner. (R. 14-17)

On June 16, 1938, petitioner was adjudicated bankrupt under Section 75(s).

On April 1, 1940, the three-year stay and rental order became effective. Only one full year's rental was paid.

On November 23, 1942, the Federal District Court found that the amount owing to respondent by petitioner as of October 3, 1942, was $81,138.84, and under the same order the value of petitioner's property was determined and a reasonable time in which to redeem under the first proviso of Setcion 75(s) (3) was fixed. (R. 5, 6) Petitioner failed to pay the value into Court.

On February 18, 1944, respondent filed a request for a sale of its security at public auction in accordance with the second proviso of Section 75(s) (3).

II

QUESTION PRESENTED

The sole question presented by the petition for certiorari is whether the Circuit Court of Appeals, Tenth Circuit, erred in dismissing petitioner's appeal. Obviously, the answer to this question depends upon whether the question before the Circuit Court became moot.

III

THE SOLE QUESTION BEFORE THE CIRCUIT COURT OF APPEALS, TENTH CIRCUIT, WAS WHETHER THE FORECLOSURE DECREE IN THE STATE COURT WAS BINDING ON THE BANKRUPTCY COURT.

The order of the Federal District Court was dated June 26, 1944. (R. 45-48) The decree of foreclosure entered in the Utah state court *prior to the filing of petitioner's petition under Section 75* was held to be "in all respects valid and binding upon this Court in this proceeding." (R. 47) The petitioner had offered to pay the sum of $66,510.84 in full satisfaction of the indebtedness of $81,138.84 owing to

respondent, which amount the court found in this order to be substantially insufficient in amount to satisfy said indebtedness. At the hearing, from which the order appealed from resulted, *the Federal District Judge expressly reserved consideration of the expenditures made by respondent until the final hearing on the confirmation of the sale*, which the court then contemplated would be made by the trustee under the second proviso of Section 75 (s) (3). Accordingly, the sole question that could properly have been presented to the Circuit Court of Appeals was whether the decree of foreclosure entered in the state court was binding on the bankruptcy court.

IV

THE SOLE QUESTION BEFORE THE CIRCUIT COURT OF APPEALS WAS MADE MOOT BY PETITIONER'S VOLUNTARY PAYMENT OUT OF COURT OF THE AMOUNT CLAIMED UNDER THE FORECLOSURE DECREE.

On August 18, 1944, while the appeal was pending, petitioner voluntarily paid to the respondent $86,949.82, the total amount claimed by respondent, although approximately $17,000.00 thereof was paid under protest. This money was paid to respondent, without any court approval. By this voluntary payment, made out of court, the entire indebtedness due and owing to respondent was satisfied, and, except for a small portion of the mortgaged property that was later sold under court order, the property remained under the bankruptcy court's jurisdiction.

As the Circuit Court of Appeals had before it the sole question as to whether the foreclosure decree was binding upon the bankruptcy court, the question manifestly became moot when the judgment was paid voluntarily by petitioner.

Therefore, it is respectfully submitted that the Circuit Court of Appeals did not err in dismissing the appeal, and in holding that any right petitioner "claimed to recover what it had paid under protest would have to be asserted in an independent action brought by it against the bank." (R. 56)

V

THE QUESTIONS RAISED BY PETITIONER ARE IRRELEVANT.

In its petition and supporting brief petitioner gives no consideration to the question before this Court, but directs its petition and argument to the merits, not only of the sole question before the Circuit Court of Appeals, but of the question which the District Judge expressly reserved for future consideration. Without conceding their relevancy respondent will discuss, in the order adopted by petitioner, the several reasons given by it as to why its petition should be granted. (Petition for Writ, p.p. 4, 5)

1. Section 75(b) of the Bankruptcy Act has no bearing whatsoever on the question presented to the Circuit Court of Appeals. The provisions thereof pertain exclusively to proceedings under Subsections (a-r) and not to proceedings under Subsection (s).

2. As the District Judge had not decided the question of attorney fees and other costs and expenses, the dismissal of the appeal could not amount to a decision that said fees and expenses were proper. In any event, Section 62(d) of the Bankruptcy Act, 11 U.S.C., 102(d), applies solely to attorney fees which are sought to be paid from the general assets of the estate as an expense of administration. This is not a case where, as petitioner infers, attorneys have been allowed fees without following statutory procedure. Respon-

dent's position as to its attorney fees and expenses has been that under the terms of its mortgages it is entitled to include as a part of its lien outlays made for the protection of its mortgages. In the foreclosure decree of the state court the Court found:

> "that it is provided in each said mortgage that in the event suit is instituted to foreclose the same any sums paid by the mortgagee for the protection of its mortgage, including costs, legal expenses and attorney's fees, shall be deemed part of the debt secured by each said mortgage;" (R. 15)

Respondent's contention is that, when bankruptcy proceedings are instituted under Section 75 of the Bankruptcy Act during the pendency of a foreclosure action, the reasonable expenses to which the mortgagee is put in protecting its interests in the bankruptcy court are such costs and expenses as are contemplated under the terms of its mortgages.

3. and 4. Neither Section 791 (Fifth) nor Section 983, Title 12, U. S. C. prohibits respondent from demanding and receiving attorney fees and other expenses in a foreclosure action.

This Court, in the case of *The Federal Land Bank of Berkeley* v. *Warner*, 292 U. S. 53, 54 S. Ct. 571, wherein Title 12 U. S. C., Section 983, was under consideration, stated:

> "The act establishes cooperation between borrowers on farm mortgages and investors in the bonds secured by them. The requirement, by means of the mortgage provision, *that a mortgagor shall bear the expense put upon the bank by his default is reasonable and in harmony with that principle.*"*

*All emphasis to quotations added throughout this brief.

5. The foreclosure decree in the Utah state court had not been taken by default and there had been no appeal. It was not subject to collateral attack as being void or erroneous. The law under which petitioner claims that the foreclosure decree provides for interest on the judgment at an improper rate was in effect when the foreclosure decree was entered. It is a well recognized presumption that the trial court considered all questions necessary for the issuance of the decree (15 R.C.L. 876). Even if the state court had incorrectly interpreted this Federal statute, such interpretation can be corrected only on appeal. (*Union Joint Stock Land Bank* v. *Byerly*, 310 U. S. 1, 60 S. Ct. 773; *Bernards* v. *Johnson*, 62 S. Ct. 30.)

Under no circumstances can it properly be said that *the dismissal of the appeal* sanctions the utter disregard of Title 12 U.S.C., Section 771 (Twelfth), as contended by petitioner.

There is an indisputable answer to petitioner's argument as to the legality of the foreclosure decree. Three mortgages were involved. The first two notes and mortgages were dated December 1, 1921. Principal and interest were payable in semi-annual installments over a period of thirty-three years. The installment dates were June 1 and December 1 each year. The interest rate was six per cent. The other note and mortgage were dated January 1, 1931. Principal and interest were payable in semi-annual installments over a period of thirty-four and one-half years. The installment dates were January 1 and July 1 each year. The interest rate was five and one-half per cent.

Several sections of the Federal Farm Loan Act (12 U.S.C., Chap. 7) must be considered. The first of the pertinent sections reads in part as follows:

"Section 771, Second. Every such mortgage shall contain an agreement providing for the repayment of the loan on an amortization plan by means of a fixed number of annual or semi-annual installments sufficient to cover, first, a charge on the loan at a rate not exceeding the interest rate in the last series of farm loan bonds issued by the Land Bank making the loan; second, a charge for administration and profits at a rate not exceeding, except with the approval of the Governor of the Farm Credit Administration, 1 per centum per annum on the unpaid principal, said two rates combined constituting the interest rate on the mortgage; and, third, such amounts to be applied on the principal as will extinguish the debt within an agreed period, not less than five years nor more than forty years."

The interest rate on the last series of farm loan bonds issued before the execution of the first two mortgages in this case was five per cent. The interest rate on the last series of farm loan bonds issued before the execution of the other mortgage was four and one-half per cent. These rates, plus the one per cent additional provided for in the Act, constituted the six per cent and the five and one-half per cent rates at which the respective notes and mortgages were written. Accordingly, these were the contract interest rates on the non-delinquent portions of the indebtedness. Reference is made to the *non-delinquent* portion of the indebtedness because Section 771, Ninth, provides that "Every borrower shall pay simple interest on *defaulted* payments at the rate of eight per cent per annum. . . ."

Therefore, we have Section 771, Second, pertaining exclusively to interest on *non-delinquent* indebtedness, and Section 771, Ninth, pertaining exclusively to interest on *delinquent* indebtedness. *Paragraphs "Second" and "Ninth" have been a part of the Federal Farm Loan Act since its enactment in 1916.*

During the depression, on May 12, 1933, Paragraph "Twelfth" was added to Section 771, and has since been amended. The pertinent portion thereof now reads as follows:

> "Notwithstanding the provisions of Paragraph 'Second' of this section, the rate of interest on any loans on mortgages made through national farm loan associations . . . by any Federal Land Bank, outstanding on May 12, 1933, or made through national farm loan associations after such date, shall not exceed 3½ per centum per annum *for all interest payable on installment dates occurring within a period of five years" (nine years, as amended June 27, 1942) "commencing July 1, 1935;* and no payment of the principal portion of any instalment of any such loan outstanding on June 3, 1935, shall be required prior to July 11, 1938, *if the borrower shall not be in default with respect to any other condition or covenant of his mortgage* . . . the Secretary of the Treasury shall pay each Federal Land Bank as soon as practicable after October 1, 1933, and after the end of each quarter thereafter, such amount as the Land Bank Commissioner certifies to the Secretary of the Treasury is equal to the amount by which interest payments on mortgages held by such bank have been reduced, during the preceding quarter by reason of this paragraph; . . . there is authorized to be appropriated, . . . the sum of $15,000,000.00 for the purpose of enabling the Secretary of the Treasury to make payments to Federal Land Banks which accrue during the fiscal year ending June 30, 1934, and such additional amounts as may be necessary to make payments accruing during subsequent fiscal years."

Petitioner contends that the foregoing section has been incorrectly interpreted for the past twelve years by the Farm Credit Administration, the twelve Federal Land Banks of the system and the Secretary of the Treasury. That is, it contends that an interpretation which it places on the sec-

tion, which is absolutely contrary to the interpretation which has been followed by all concerned during the past twelve years, is correct.

In the *Warner* case *supra*, the Supreme Court of the United States, in referring to the interpretation of a portion of the Federal Farm Loan Act, said:

> "From this it appears that officers charged by law with the administration of the banks *have always construed the Act* to permit state laws to control. Our attention has not been called to any case in which that construction has been questioned. *It is entitled to great weight. U. S.* v. *Mo. Pac. R. Co.*, 278 U. S. 269, 280."

Petitioner's position is that by the amendment to Section 771, Twelfth, Congress intended to provide that between its effective dates the *delinquent* interest rate under Paragraph "Ninth," as well as the *non-delinquent* rate under Paragraph "Second," was reduced to three and one-half per cent. The fallacy of this contention is self-evident. If Congress had so intended, the amendment would surely have read in part: "Notwithstanding the provisions of Paragraph 'Second' *and Paragraph 'Ninth'* of the section, the rate of interest . . . shall not exceed 3½ per centum per annum." Since Paragraph "Ninth," pertaining exclusively to interest on delinquent indebtedness, was not mentioned in Paragraph "Twelfth," the amendment cannot, under any rule of construction, be interpreted to include said Paragraph "Ninth."

Petitioner gives no consideration to the portion of the paragraph following "3½ per centum per annum." To complete the sentence wherein these words appear we find the *pertinent limitation* which, during the past twelve years, has

governed all concerned, but which appellant ignores. The complete statement is that interest shall not exceed "3½ per centum per annum *for all interest payable on installment dates* occurring within a period of (nine) years." All Land Bank notes and mortgages are written, as required by the Act, on the amortization plan, under which principal and interest are payable in semi-annual installments *on the installment dates* mentioned in the notes and mortgages.

In considering Paragraph "Second," which was amended, Congress knew that the notes and mortgages must provide for payment of interest on annual or semi-annual installment dates, and that Paragraph "Ninth," *which was not amended, did not provide that the eight per cent interest should be paid on installment dates.* The very simple method of limiting the reduced rate to *non-delinquent* installments as they became due was to limit it to "*all interest payable on installment dates.*"

Petitioner has not been charged in excess of three and one-half per cent per annum for interest which was "payable on installment dates," beginning July 1, 1935. On each such installment date, when interest became payable, petitioner was charged only three and one-half per cent and the remaining two and one-half per cent on the six per cent loans and the remaining two per cent on the five and one-half per cent loan was collected from the Secretary of the Treasury. However, after petitioner's default and the resultant acceleration of the maturity of the unmatured balance of the loans for the purpose of instituting foreclosure, interest was no longer "payable on installment dates," since the terms of the notes and mortgages which provided for the payment of interest *on installment dates* were no longer of any force and effect, the whole indebtedness being due by reason of the fact

that the Bank exercised its right to accelerate the maturity because of petitioner's default. Petitioner's major complaint as to interest is that on the amounts found in the foreclosure decree to be due, the state court fixed the interest rate at the state statutory rate for interest on judgments, instead of at the rate of 3½ per cent.

Petitioner also contends that respondent's Board of Directors voluntarily reduced the interest on delinquent accounts to 3½ per cent per annum. Petitioner quotes the action taken by respondent's Board of Directors on August 29, 1939. Since this action was taken nearly eighteen months *after* the decree in foreclosure was entered, (R. 14, 15) it is manifest that it could have had no bearing whatsoever on the amount of the judgment in the foreclosure action.

As to the first two mortgages, the foreclosure decree provides that respondent shall have judgment for specific amounts "with interest thereon at six per cent a year from date of judgment, and any accruing costs paid by plaintiff." As to the other mortgage, the decree contains the same provision, except that the interest rate on the judgment is stated to be five and one-half per cent. It must be petitioner's contention that the Board of Directors' action, which certainly was not retroactive, had the effect of changing the provisions of the foreclosure decree, so that subsequent to September 1, 1939, respondent was entitled to but three and one-half per cent interest on the three specific sums found to be due and for which judgment was entered.

The action of the Board of Directors taken on August 29, 1939, states that it was "decided to reduce the *penalty interest* rate from 6 per cent to 3½ per cent." Section 12, Ninth, of the Federal Farm Loan Act, *supra*, prescribes the interest rate to be charged on "defaulted" payments, which

is "penalty interest." The interest on a judgment procured in a foreclosure action is not penalty interest, and is never referred to as such. After a mortgage has been reduced to judgment, the interest rates on *loans* are no longer applicable, as the mortgage is superseded by the judgment. The State law as to the interest allowed on judgments then applies, which, in Utah, is the rate provided for in the contract. (Utah Code Ann. 1943, Sec. 44-0-4).

6. The "claim" to which petitioner refers is respondent's demand, *out of court*, for repayment of the total indebtedness due it, including expenses to which it was put during the bankruptcy proceedings, in consideration that it release its lien of the foreclosure judgment. Since the District Judge expressly deferred consideration thereof, the issue was not before the Circuit Court.

7. Petitioner, on its own initiative, abandoned the statutory method of having respondent's claim settled by the bankruptcy court after a sale under the second proviso of Section 75(s) (3), and voluntarily paid the full amount of the indebtedness due and owing. It now complains because the Circuit Court left petitioner where it, the petitioner, had placed itself.

Respectfully submitted,

RICHARD W. YOUNG,
MORTON G. HOFFMANN,
(Berkeley, California)
Counsel for Respondent.